Currency Trouble in Malawi

When the former World Bank economist Bingu wa Mutharika became president of the East African nation of Malawi in 2004, it seemed to be the beginning of a new age for one of the world's poorest countries. In landlocked Malawi, most of the population subsists on less than a dollar a day. Mutharika was their champion. He introduced a subsidy program for fertilizer to help poor farmers and gave them seeds. Agricultural output expanded, and the economy boomed, growing by 7 percent per year between 2005 and 2010. International donors loved him, and aid money started to pour in from the United Kingdom and the United States. By 2011, foreign aid was accounting for more than half of Malawi's annual budget.

In 2009, to no one's surprise, Mutharika was reelected president. Then things started to fall apart. Mutharika became increasingly dictatorial. He pushed aside the country's central bankers and ministers to take full control of economic policy. He called himself “Economist in Chief.” Critics at home were harassed and jailed. Independent newspapers were threatened. When a cable from the British ambassador describing Mutharika as “autocratic and intolerant of criticism” was leaked, he expelled the British ambassador. Britain responded by freezing aid worth $550 million over four years. When police in mid-2011 killed 20 antigovernment protestors, other aid donors withdrew their support, including most significantly the United States. Mutharika told the donors they could go to hell. To compound matters, tobacco sales, which usually accounted for 60 percent of foreign currency revenues, plunged on diminishing international demand and the decreasing quality of the local product, which had been hurt by a persistive drought.

By late 2011, Malawi was experiencing a full-blown foreign currency crisis. The International Monetary Fund urged Mutharika to devalue the kwacha, Malawi's currency, to spur tobacco and tea exports. The kwacha was pegged to the U.S. dollar at 170 kwacha to the dollar. The IMF wanted Malawi to adopt an exchange rate of 280 kwacha to the dollar, which was closer to the black market exchange rate. Mutharika refused, arguing that this would cause price inflation and hurt Malawi's poor. He also refused to meet with an IMF delegation, saying that the delegates were "too junior." The IMF put a $79 million loan program it had with Malawi on hold, further exacerbating the foreign currency crisis. Malawi was in a tailspin.

In early April 2012, Mutharika had a massive heart attack. He was rushed to the hospital in the capital Lilongwe, but ironically, the medicines that he needed were out of stock—the hospital lacked the foreign currency to buy them! Mutharika died. Despite considerable opposition from Mutharika supporters who wanted his brother to succeed him, Joyce Banda, the vice president, was sworn in as president. Although no one has stated this publicly, it seems clear that intense diplomatic pressure from the United Kingdom and United States persuaded Mutharika's supporters to relent.

Once in power, Banda announced that Malawi would devalue the kwacha by 40 percent. For its part, the IMF unblocked its loan program, while foreign donors, including the UK and United States, stated that they would resume their programs.

Case Discussion Question

1. What were the causes of Malawi's currency troubles?

2. Why did Murtharika resist IMF calls for currency devaluation? If he had lived and remained in power, what do you think would have happened to the economy of Malawi assuming that he did not change his position?

3. Now that Malawi currency has been devalued, what do you think the economic consequences will be? Is this good for the economy?